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In The

Supreme Court of the United States

October Term, 1961

No. 497

Estate of Helen Davison, Deceased, First National Bank of Arizona, Executor,

Petitioner,

vs.

The United States.

Petition for a Writ of Certiorari to the United States Court of Claims.

W. Lee McLane, Jr.,
Nola McLane,
27 North Country Club Drive,
Phoenix, Arizona,
Counsel for Petitioner.

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vs.

The United States.

Petition for a Writ of Certiorari to the United States Court of Claims.

The Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Claims entered in the above-entitled case on July 19, 1961.

Opinion Below.

The opinion of the Court of Claims, printed in Appendix A, *infra,* is reported at 292 F. 2d 937.

Jurisdiction.

The order of dismissal of petitioner's Petition by the United States Court of Claims was entered on July 19, 1961. (App. A, *infra.*) Petitioner's application for a certified transcript of record was allowed on September 22, 1961 by the Court of Claims. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1255(1).

Question Presented.

Whether a decedent's interest in growing crops which interest is attributable to the provisions of leases under which farm lands owned by the decedent were leased prior to her death, constitutes "income in respect of a decedent" within the meaning of that term as used in the Internal Revenue Code.

Statutes Involved.

The pertinent provisions of Section 126 of the 1939 Internal Revenue Code and Section 691 of the 1954 Revenue Code are set forth in Appendix B, *infra*.

Statement.

The decedent, Helen Davison, died on December 24, 1952. Prior to her death, she reported her income on the cash basis of accounting. [Findings of Fact 3 and 5.] At the time of her death decedent owned two parcels of real property. One parcel, 320 acres located in Coolidge, Arizona (hereafter referred to as the Coolidge tract), had been leased by decedent to one Fred Jones for the period January 1, 1952 to January 1, 1953. The lease provided that decedent was to be paid as rent one-fourth of all crops grown on the 320 acres. [Findings of Fact 6 and 7.] The second parcel of land, 640 acres located in Eloy, Arizona (hereafter referred to as the Eloy tract), had been leased by decedent to one Leland Jones and one Mike Jones, who later assigned the lease to Jones Ranch Enterprises, Inc. The term of this second lease covering the Eloy tract was from February, 1952 until January 1, 1953. It was provided in this lease that decedent was to be paid, as rent, one-half of the net proceeds

of all crops grown on the 640 acres. [Findings of Fact 6, 8 and 9.] Both tracts were planted to cotton by the respective lessees.

Subsequent to decedent's death on December 24, 1952, her estate, the petitioner herein, received, pursuant to the Fred Jones lease on the Coolidge tract, a total of $14,137.14 during February of 1953. [Finding of Fact 11.] Thereafter, the decedent's estate received $14,429.43 from Jones Ranch Enterprises, Inc. pursuant to the lease on the Eloy tract. [Finding of Fact 16.] However, this latter amount of $14,429.43 was not determined, because of a dispute between the decedent's estate and Jones Ranch Enterprises, Inc. as to the amount due, until January 27, 1954. [Finding of Fact 16.]

The above described amounts of $14,137.14 and $14,429.43 were included in Schedule F of the Federal estate tax return of the Estate of Helen Davison as a part of the gross estate of the decedent. [Findings of Fact 13 and 18.] Thereafter, the Commissioner of Internal Revenue treated the amount of $14,137.14 as income in respect of a decedent for the year 1953 and the amount of $14,429.43 as income in respect of a decedent for the year 1954. [Findings of Fact 12 and 17.] The petitioner paid the resulting deficiency of $11,892.11 for the year 1954 plus interest thereon in the amount of $2,066.62 to the District Director of Internal Revenue at Phoenix, Arizona and, thereafter, filed with the same District Director a timely claim for the refund of said amounts, together with a claim for the refund of $489.55 of income tax paid for the year 1953. [Findings of Fact 23, 25 and 26.] On May 7, 1958, the District Director at

Phoenix, Arizona formally disallowed petitioner's claims for refund. [Finding of Fact 27.] On July 28, 1958, petitioner filed a Petition with the United States Court of Claims seeking a refund of the amounts claimed in the rejected claims for refund for the years 1953 and 1954. (Record 1.)

REASONS FOR GRANTING THE WRIT.

I.

The Decision of the Court of Claims Below in the Instant Case Conflicts With the Applicable Decisions of This Court.

The phrase "gross income in respect of a decedent" as used in Section 126 of the 1939 Internal Revenue Code and in Section 691 of the 1954 Internal Revenue Code means "gross income accrued up to the date of death of a decedent". The committee reports on Section 126 of the 1939 Code clearly so provided. They pointed out that, under former Section 42 of the 1939 Code, the final return of the decedent included "all income *accrued* up to the date of his death" and that the new Section 126 "changes the existing law by providing that *such amounts*"[1] should be taxed to the persons receiving them. The committee reports on Section 691 of the 1954 Code again state that "the 1942

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[1]The committee reports on Section 126 state:

"Since the Revenue Act of 1934 the revenue laws have contained provisions including in the income of a decedent for the period in which falls the date of his death all income *accrued* up to the date of his death not otherwise properly includible in respect of such period or a prior period. . . . This section changes the existing law by providing that *such amounts* shall not be included in the decedent's income but shall be treated . . ." H. Rep. No. 2333, 77th Cong., 1st Sess., 1942-2 Cum. Bull. 372 at 435-436; S. Rep. No. 1631, 77th Cong., 2d Sess., 1942-2 Cum. Bull. 504 at 579-580. (Emphasis supplied.)

amendments made the income *accrued* solely by reason of the decedent's death taxable to the actual recipient."[2]

The courts have interpreted the phrase in conformity with that expressed congressional intent. For example, in *Lacomble v. United States*, D. C. N. D. Calif. S. D. 1959, 177 Fed. Supp. 373, 375, the court stated ". . . Sections 126 and 691 make the income accrued solely by reason of his death taxable to the actual recipient when received . . ." In *Estate of Ralph R. Huesman*, 16 T. C. 656, 661 (aff'd. C. A. 9, 198 F. 2d 133), the Tax Court pointed out that ". . . section 126 of the Code was added by the Revenue Act of 1942 to provide that income accruing to a decedent because of his death was not includible in his final return but was to be treated as income and reported as income by the one receiving the right to such income . . ."

"Accrued income" has been clearly defined in *Spring City Foundry Company v. Commissioner*, 292 U. S. 182, 184 wherein it was said:

> Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that is the *right to receive* and not the actual receipt that determines the inclusion of the amount in gross income. When the *right to receive* an amount becomes fixed, the right accrues. (Emphasis supplied.)

Helvering v. Enright, 312 U. S. 636, 645, cited the foregoing definition and added thereto that income ac-

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[2]H. Rep. No. 1337, 83rd Cong., 2d Sess. A219 (1954); S. Rep. No. 1622, 83rd Cong., 2d Sess., 373 (1954). (Emphasis supplied.)

crued at death must be "capable of approximate valuation" and that "the requirement of valuation comprehends the elements of collectibility."

Citing *Spring Foundry Co. v. Commissioner, supra*, and later cases as authority, Mertens treatise on the Law of Federal Income Taxation states the present rule as follows:

> Items may and must be accrued when the events occur which fix the amount due and determine the liability to pay. It is commonly stated that an item should be accrued when (1) all the events have occurred which fix the amount of the claim and determine the question of liability; (2) the amount is readily ascertainable; and (3) the liability therefor is determined rather than contingent.[3]

Therefore, to cause income to accrue the taxpayer must have something more than a mere "right to" income. He must have a "right to receive" income. The word "receive" as used here means that the taxpayer must be entitled to payment of the income in the sense that it is definitely collectible by him.[4] This was made very clear in *Estate of Henry W. Putnam et al. v. Commissioner*, 324 U. S. 393. In that case the decedent owned stock in a corporation which had declared a dividend prior to his death but the dividend was payable (as of a record date) after his death. As

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[3]2 Mertens, Law of Federal Income Taxation, Sec. 12.76 (1955 ed.).

[4]2 Mertens, Law of Federal Income Taxation, Sec. 12.75, states the rule: "A right to or a liability for a fixed and determinable amount does not require or permit accrual if the item is uncollectible."

soon as the corporation had declared the dividend, it had thereby segregated a part of its earned surplus as a liability payable to its shareholders. Consequently, the stockholders, including the decedent, had a fixed "right to" that dividend at that time. However, they did not have a "right to receive" the dividend until the time when it became payable which was after the decedent's death. Although the decedent had a "right to" the dividend prior to his death and he was certain to eventually receive that dividend when it was paid (unless he disposed of the stock in the meantime), this Court held that he did not have the "right to receive payment upon the declaration" of the dividend. It is only the separation of the corporate earnings "by a completed dividend, which assigns a part of those earnings to a stockholder", that gives to the stockholder a right to the payment of the dividend as being collectible by him. Therefore, this Court held that the dividend had not accrued at the decedent's death (under Sec. 42 of the 1939 Code) because it still left the "identity of the recipient at large" until such time as the dividend became payable to him, and "such uncertainty destroys any conception of accrual as involving a right to receive or an obligation to pay, elements which we think are essential for accruals under our decision". The result is that it must be certain that the decedent has a conclusive "right to receive payment" of the income, so that it is definitely collectible by him, in order that income may be accrued at his death.

In the case at hand the decedent had a "right to" one-half of the net profits of all crops grown on the Eloy tract. But until such time as the cotton had

been grown, harvested, ginned, baled, sold and the net profit ascertained, she had no conclusive right to receive payment in any amount. This is pointedly borne out by the fact that although the first interim statement of settlement of the account was submitted to the executor of decedent's estate on April 2, 1953, because of a dispute with the lessee as to the exact amount of net profit realized from the cotton crop no agreement as to the rental due for the 1952 crop year was reached until January 27, 1954.

With respect to the Coolidge tract the decedent had a right to one-fourth of the crops grown on the land. Obviously she had no conclusive right to receive payment of anything until a mature cotton crop had been harvested, ginned and baled. The decedent had in fact received, prior to her death, her share of the baled cotton that had resulted from the first pickings. She had reduced that baled cotton to income by sale of it and those proceeds were included as income in her final return. However, the remainder of the crop had not been completely harvested, ginned and baled until February, 1953, after her death. If, in the interval, the remainder of the crop had been destroyed by fire, wind or other holocaust her estate would not have been entitled to receive any additional payment.[5]

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[5]In *Silveira v. Ohm* (Cal., 1949), 201 P. 2d 387, 389, 33 Cal. 2d 272, 275, Judge Traynor said:

> "Rent payable in crops is not due, however, until the crops are harvested or until a reasonable time after their maturity (cases cited) . . . It is true that the crops may never mature or may be destroyed without the fault of either party, or market conditions may render them of little value. . . . If the crops do not materialize and the lessee has not violated covenants and conditions of the lease, then by the terms of the agreement itself no rent is due. . . ."

Since the decedent under the terms of both leases and the circumstances existing at her death had no right to receive payment of any kind there could not have been any rental income accrued by reason of her death. In holding that the crop rentals were fully accruable on the date of her death the Court of Claims has handed down a decision that is in direct conflict with the decisions of this Court in *Estate of Henry W. Putnam et al. v. Commissioner*, 328 U. S. 393 and *Spring City Foundry Company v. Commissioner* 292 U. S. 182.

Furthermore, in reaching its decision the Court of Claims relied upon a series of four cases decided by the United States Court of Appeals for the Second Circuit. Three of the decisions are traceable to and dependent upon the fourth decision of that court in *O'Daniel's Estate v. Commissioner*, C. A. 2 1949, 173 F. 2d 966. The decision reached in *O'Daniel's Estate, supra*, in turn, was dependent upon the construction of the word "accrued" reached in yet another Second Circuit decision, *Commissioner v. Guaranty Trust Co. of New York*, C. A. 2, 1944, 144 F. 2d 169. However, at the time that the Second Circuit thus relied on *Commissioner v. Guaranty Trust Co. of New York, supra*, that case had already been reversed, four years earlier, under the title of *Estate of Henry W. Putnam, Guaranty Trust Company of New York, Executor v. Commissioner*, 324 U. S. 393 (1944). Needless to say, the Second Circuit's decision in the leading case, *O'Daniel's Estate, supra*, insofar as it is dependent upon the construction of the word "accrued" handed down in *Guaranty Trust Co., supra*, is in conflict with and contrary to this Court's holding in *Estate of Henry*

W. Putnam et al. v. Commissioner, supra. To the extent that the Court of Claims' decision in the instant case is likewise dependent upon the series of Second Circuit decisions and their inherent misconstrual of the word "accrued", it, too, is in conflict with this Court's decision in *Estate of Henry W. Putnam et al. v. Commissioner, supra.*

II.

The Decision of the Court of Claims Below in the Instant Case Results in an Unconstitutional Application of the Statute Involved.

At her death decedent's interest in the growing cotton crops passed to her estate as a property right and became part of the principal of her estate. The Court of Claims below has held that that property interest in the hands of her estate was taxable as "*income* in respect of a decedent". That unwarranted construction and consequent application of Section 126 of the 1939 Code and Section 691 of the 1954 Code imposes a direct tax on the principal of decedent's estate in violation of the Constitution of the United States.[6] A direct tax on principal, as distinguished from income, is unconstitutional unless equally apportioned among the States according to population. *Pollock v. Farmers Loan and Trust Co.*, 157 U. S. 429; *Eisner v. Macomber*, 252 U. S. 189.

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[6]Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4, of the Constitution of the United States.

III.

The Decision of the Court of Claims Below in the Instant Case Is Contrary to the Manifest Plan of Congress in the Enactment of Section 126(a).

There is no basis in fact to support the conclusion that Congress in enacting Section 126(a) intended to do anything other than to place cash basis taxpayers and accrual basis taxpayers on equal footing for the purpose of treating income accrued up to the date of their death. The related committee reports reflect an awareness of the effect of *Helvering v. Enright*, 312 U. S. 636 in causing a hardship on cash basis taxpayers and an expressed purpose of eliminating that hardship.[7] There is no comment in this report whatever to indicate that the 1942 amendments amounted to anything more than such a relief provision.

Moreover, on December 30, 1958, Chairman Wilbur D. Mills of the Subcommittee on Internal Revenue Taxation transmitted to the Committee on Ways and Means of the House of Representatives the Final Report[8] of an advisory group appointed to study Subchapter J of the 1954 Revenue Code. This Final Report proposed that certain amendments be made to

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[7] H. Rep. No. 2333, 77th Cong., 1st Sess., 1942 2 Cum. Bull. 372 at 430; S. Rep. No. 1631, 77th Cong., 2d Sess., 1942 2 Cum. Bull. 504 at 580.

[8] Final Report on Estates, Trusts, Beneficiaries and Decedents, Received by the Subcommittee on Internal Revenue Taxation and Transmitted to the Committee on Ways and Means, U. S. House of Representatives from the Advisory Group on Subchapter J of the Internal Revenue Code of 1954, December 30, 1958.

Section 691. Included among them was a subsection which defined "income in respect of a decedent" which read in part as follows:

> Sec. 691(a) INCOME IN RESPECT OF DECEDENTS DEFINED.—For purposes of this section, the term "income in respect of a decedent" means an amount not includible in the decedent's gross income for the taxable period in which falls the date of his death or a prior taxable period—
>
> (1) Which would have been includible in the gross income of the decedent if he had computed his income for such period under an accrual method of accounting, except that no amount of unrealized appreciation in value of property, whether attributable to inventory items or otherwise, shall be income in respect of a decedent under this paragraph (1), . . .[9]

In the "Comment" accompanying said proposed amendment the Report states:

> The statute never has defined income in respect of a decedent, which has led to some uncertainty and confusion. It is proposed to add a new subsection (a) to supply such a definition, which affirmatively defines what is income in respect of a decedent. If an item does not fall within subsection (a), it is not income in respect of a decedent.

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[9]Said proposed amendment became Section 19 of H. R. 3041 introduced in the 86th Cong., 1st Sess., by Mr. Mills and which failed to be enacted into law. The proposed amendment of Section 691 was dropped from the successor to H. R. 3041, H. R. 9662, 86th Cong., 2d Sess.

> Section 691(a)(1) states what has been the primary rule under present law, *i.e.*, that any income accrued up to the date of the death of a decedent who reported his income on the cash basis constitutes income in respect of a decedent. It is intended, however, that for the purposes of paragraph (1) the term "accrual method of accounting" contemplates the application of the same rules as would be applied in determining the income of a living taxpayer who computes his income under the accrual method of accounting subject to the exception set forth in paragraph (1), relating to unrealized appreciation. Examples of items includible under this paragraph are: Interest which accrues day by day; rents and royalties for patents, copyrights, and secret processes which accrue on the date they become due under the lease or license; and damages which accrue on the date they become fixed, whether by final judgment or agreement.[10]

It is clear that Congress intended to treat as income in respect of a decedent only that income which had accrued up to the date of the death of the decedent and to treat cash basis taxpayers and accrual basis taxpayers alike.

In the opinion handed down by the Court of Claims in the instant case, Chief Judge Jones stated that one of the "important considerations" that resulted in the

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[10]Final Report, ftnt. 6, *supra*, at p. 327. In addition, it should be noted that a "living taxpayer who computes his income under the accrual method of accounting" is directed to include crop shares received as rent in gross income "as of the year in which the crop shares are reduced to money or the equivalent of money." Reg. 1.61-4(b), Int. Rev. Code of 1954.

conclusion that plaintiff had been in receipt of income in respect of a decedent was that "the rents received . . . would have been income to the decedent had she but lived to receive them". This concept that "if the item would have been income had the decedent but lived to receive it, then it is income in respect of decedent" results from a misreading of Congressional intent as reflected in subsection (c) of Section 126(a) of the 1939 Code and Section 691(a) of the 1954 Code. That subsection reads as follows:

> (3) *Character of income* determined by reference to decedent.—The right described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise or inheritance from the decedent, as if it has been acquired by the estate or such person in the transaction by which the decedent acquired such right; *and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.* (Emphasis supplied.)

As readily noted that subsection merely provides that "the right" of the decedent to receive the accrued income under Section 126(a)(1) or 691(a)(1) above shall have *the same character* in the hands of the person who receives it as it would have had if the decedent had lived to receive it. In other words, if the income accrued up to the date of the decedent's death is a dividend, then it will retain its character as a

dividend and be taxed as a dividend to the recipient thereof. If the income accrued up to the date of decedent's death is a capital gain, then it will retain its character as capital gain in the hands of the recipient of same.[11] There is no basis whatsoever for holding that the subsection meant to apply the reverse situation, namely that all income that would have been income to the decedent, if she had lived, should be taxed as income accrued at her death under Section 126(a)(1) or Section 691(a)(1). Such a fallacious argument would result in *all* income of an estate being taxable under Section 126(a)(1) or Section 691(a)(1) since all income of the estate would have been income to the decedent if she had lived. Such an argument would also nullify the provisions of Sections 641 and 1014 of the 1954 Code which relate to the taxability of income of the estate to the estate as estate income.

Nonetheless, the court below, like the courts that decided the cases it cites as supporting authority, has relied on such a fallacy. The court in *Linde v. Commissioner,* C. A. 9, 1954, 213 F. 2d 1, went so far as to state that subsection (c) of Section 126(a) "contains strong evidence of congressional intent to see to it that the tax upon income which would have been derived had the decedent lived should not be lost to the treasury in consequence of his death". It is that statement, and similar ones by other courts, all based upon a misreading of subsection (c), which, in turn, caused the lower court to rely in reaching its decision, upon

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[11]H. Rep. No. 2333, 77th Cong., 1st Sess., 1942-2 Cum. Bull. 372, 437; S. Rep. No. 1631, 77th Cong., 2d Sess., 1942-2 Cum. Bull. 504, 581.

"the important consideration" that "the rents . . . would have been income to the decedent has she but lived to receive them".

Again, respecting Congressional intent, the lower court in its opinion stated: "We think it clear that the intent of the Congress in enacting this section (Sec. 126) continued to be, as stated by the Supreme Court in *Enright*, 'to cover into income the assets of decedents, earned during their life and unreported as income'. 312 U. S. at 644". Since the lower court obviously concluded that the crop rents uncollectible at the date of decedent's death were assets to be treated as income in respect of decedent in accordance with the stated Congressional intent, it becomes necessary to examine more closely the cited quotation from *Helvering v. Enright*, 312 U. S. 636.

A decedent owns only two kinds of assets, property assets and accrued income assets. As discussed above, any attempt to subject the property assets of a decedent to the imposition of an income tax would be unconstitutional.

An accrued income asset is a valid, fixed "right to receive" income as property because the payment of that income is due to decedent. If she did not have a fixed right to collect the income, then it would not be an asset at all. For example, a dividend is not an income asset of the decedent unless it had become payable to her prior to her death so that she had a fixed "right to receive" it as her property. *Estate of*

Henry W. Putnam et al. v. Commissioner, 324 U. S. 393.

Therefore, when this Court held that the purpose of former Code Section 42 was to "cover into income *assets* of decedents earned during their lifetime and unreported as income", it could only have referred to accrued income assets owned by the decedent and not to property assets. That is so because an accrued income asset is income and not property. This Court merely held that the income, which an accrued income asset gave the decedent a "right to receive", should be converted into taxable income of the decedent, as if that income had been actually received. The result was to convert an asset, representing a fixed claim to income, into taxable income.

The most important point to note is that this Court held that accrued income not only had to be earned during decedent's lifetime but also had to be an *asset* of the *decedent* that he had a fixed right to collect as his property. This Court did not say that income accrued solely because it had been earned. It must also be an *asset* of the decedent, *i.e.*, income that the decedent owned at the date of his death because he had a conclusive right to collect it as his property. That agrees with the definition of accrued income as propounded by this Court in *Spring City Foundry Company v. Commissioner*, 292 U. S. 182, 184.

IV.

The Decision of the Court of Claims Below in the Instant Case Is Contrary to the Prior Consistent Construction of the Applicable Section of the Internal Revenue Code by the Commissioner of Internal Revenue, an Administrator Whose Views as to the Scope and Applicability of the Section Are Entitled to Great Weight.

In *Estate of Tom L. Burnett*, 2 T. C. 897 (1943), the Tax Court held that a cash basis decedent's inventory of livestock and feedstuff valued at $160,800.50 was not "gross income accrued to him up to the date of his death within the meaning of the language used in section 42 . . ." The Commissioner of Internal Revenue acquiesced. 1944 Cum. Bull. 4. The reported cases do not reveal any other attempts on the part of the Internal Revenue Service to relitigate the issue in the *Burnett* case, *supra*.

In 1954 a statement in the government's brief submitted in opposition to the taxpayer's application for certiorari in *Linde v. Commissioner*, October Term, 1954, No. 335, cert. den., 348 U. S. 871, indicated that the Commissioner continued to adhere to the principle of the *Burnett* decision, *supra*. It was stated therein that:

> The Commissioner does not contend that mere ownership by the decedent at the time of his death is enough to support taxation under §126. Cf. *Burnett v. Commissioner*, 2 T. C. 897 (Acquiescence, 1944 Cum. Bull. 4.)[12]

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[12]Brief for Respondent, p. 8.

In 1958 the Commissioner in a published revenue ruling[13] not only recognized the continued validity of the holding in *Estate of Tom L. Burnett, supra*, but also extended that holding by ruling that farm crops received from tenants as rents for farm lands constitute items of property and not income in respect of a decedent. That ruling did not and does not today in any way conflict with the earlier administrative practice. Nor is it in conflict with the decisions of this Court or the decisions of any of the lower courts with the exception, of course, of the Court of Claims, below, which in ruling in the instant case has held:

> We are aware that this view of the law does not accord with Rev. Rul. 58-436, 58-2 Cum. Bull. 366. We believe that ruling is an improper extension of the holding of the court in *Burnett v. Commissioner, supra*, and is not a correct exposition of the law.

On the contrary, as pointed out above, it is the ruling of the Court of Claims in the instant case which is in conflict with the decisions of this Court.

If the rejection of the petitioner's claim and the defense of this suit should be contended to be a change in the administrative practice, the sought after construction would nonetheless have to be rejected as not being consistent with the earlier decisions of this Court. *Estate of Sanford v. Commissioner*, 308 U. S. 39.

In the absence of an express revocation of Revenue Ruling 58-436 by the Commissioner, together with retroactive application of such revocation, the petitioner is

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[13]Rev. Rul. 58-436, 1958-2 Cum. Bull. 366.

being discriminated against and treated unfairly as compared to other taxpayers to whom the said revenue ruling has applied and does apply.

Petitioner submits that the legal question involved herein has been settled administratively in favor of the contentions made by petitioner and that the decision of the Court of Claims has unjustifiably unsettled that prior consistent administrative practice. Because of the doubt of the correctness of the decision of the Court of Claims in the instant case, review by this Court is desirable in order to remove the resultant confusion in the administration of the revenue laws.

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

W. LEE MCLANE, JR.,
NOLA MCLANE,
Counsel for Petitioner.

APPENDIX A.

Opinion of the Court of Claims.

In the United States Court of Claims, No. 335-58.

(Decided July 19, 1961.)

Estate of Helen Davison, Deceased, First National Bank of Arizona, Executor, v. the United States.

W. Lee McLane, Jr., for the plaintiff.

John F. Palmer, with whom was *Assistant Attorney General Louis F. Oberdorfer*, for the defendant. *Messrs. Lyle M. Turner* and *Rufus E. Stetson, Jr.*, were on the brief.

Jones, *Chief Judge*, delivered the opinion of the court:

This is a suit for the refund of Federal income taxes which were paid by the estate of Helen Davison for the years 1953 and 1954. The case concerns certain cash rents which were based on the proceeds of crop production on decedent's land and certain other rents payable in crops which were attributable to leases that ran during the year 1952. On the date of decedent's death the amounts of these rents were not ascertained. Thereafter, the estate collected both rents in full and sold the crop-rents for money. The questions presented are whether the rents received in money and the rents received in crops are taxable to the estate as income in respect of a decedent.

The facts have been found by the trial commissioner without exception by either party. The decedent, Helen Davison, was on the cash receipts and disbursements method of accounting. She died on December 24, 1952, owning two parcels of real property. One parcel, 320 acres located in Coolidge, Arizona (hereafter referred to as the Coolidge tract), had been leased by

the decedent to one Fred Jones for the period January 1, 1952, to January 1, 1953. The lease provided that the decedent was to be paid as rent "one-fourth of all *crops* grown" on the 320 acres.

The second parcel of land, 640 acres located in Eloy, Arizona (hereafter referred to as the Eloy tract), had been leased to one Leland Jones and one Mike Jones who later assigned the lease to the Jones Ranch Enterprises Corporation. The term of this lease was from February 1952, to January 1, 1953. It was provided in this lease that the decedent was to be paid as rent "one-half of the *net proceeds* of all crops grown" on the 640 acres. Each of the leases contained the customary provision that the tenant had the privilege of harvesting the balance of any crops that had not been harvested on the date of the expiration of the lease.

Up to the date of decedent's death, the local cotton gin company, on behalf of the lessees of the Coolidge tract and pursuant to that lease, had paid the decedent a total of $6,516.01 as her share of the seed credits and cotton sales for the period May 31, 1952, to October 20, 1952. This amount represented the proceeds from the sale of the decedent's one-fourth of 129 bales of cotton grown by the lessee.

In February 1953, subsequent to the death of the decedent, the cotton gin company, again on behalf of the lessee of the Coolidge tract, paid the decedent's estate the amount of $14,137.14, representing the sale price of decedent's final share of the crops.

The lessee of the 640-acre Eloy tract had made no payments to the decedent prior to her death. But in 1953 the corporation leasing the tract filed two interim statements of settlement for rent due to the de-

cedent's estate. Both of these statements were rejected by the estate. On January 24, 1954, a settlement was reached between the lessee of the Eloy tract and the estate. It was agreed that the amount of rent due, pursuant to the terms of the lease agreement, was $14,429.43. Between January 27 and February 2, 1954, the estate received this sum from the lessee corporation.

Both the $14,138.14 Coolidge tract rent payment received by the estate in 1953 and the $14,429.43 Eloy tract rent payment received by the estate in 1954 were included as a part of the gross estate of the decedent in Schedule F of the Federal estate tax return filed by the estate. Neither of these two sums was reported as income to the estate. The Commissioner of Internal Revenue adjusted the estate's income tax return to show each of these amounts received as income in respect of a decedent, and notified the estate that as a result of this adjustment the estate was subject to additional income taxes in the total amount of $11,892.11 plus deficiency interest. The estate was given credit against this additional income tax liability for the estate taxes paid as a result of the inclusion of the rent payments as part of the decedent's gross estate.

The taxpayer paid the asserted deficiency and filed timely claims for refund of income taxes for the periods 1953 and 1954 in the total amount of $13,728.28. The claims for refund were disallowed and this suit resulted.

The plaintiff maintains that the right to receive these two rental payments was part of the property of the decedent's gross estate. As such it was properly valued and taxed under the estate tax provisions. The result

was that this much of decedent's property received a new basis in the hands of the estate equal to its estate tax valuation. Since the estate received in satisfaction of these claims for rent an amount which did not exceed the basis of the claims it cannot be said that the estate has received income.

The defendant maintains that the rents received by the estate in cash and in crops, which were immediately sold for its account, represent income in respect of a decedent as set forth in section 126 of the 1939 Internal Revenue Code, 26 U. S. C. (I. R. C. 1939) §126 (1952 ed.), and section 691 of the 1954 Internal Revenue Code, 26 U. S. C. (I. R. C. 1954) §691 (1952 ed. supp. III). The plaintiff is therefore entitled to a credit for the estate taxes paid on the assessed value of the claims for rent, but the plaintiff is liable for ordinary income taxes on the amounts of rent actually collected.

As set forth above, we must determine whether these rents, both cash and crops, were properly taxed to the estate as income in respect of a decedent.

In order to understand the present state of the law some consideration must be given to its historical background. Prior to 1934 it was held by the courts under the then existing revenue statutes that money earned by a cash method taxpayer and accruable to him on the date of his death but which had not been received by him prior to his death could be collected by his estate without liability for income taxes. Such items were subject to death taxes but they escaped income taxes. *Nichols v. United States*, 64 Ct. Cl. 241 (1927). A taxpayer on the accrual method of accounting was required to pay income taxes both on

what he received and what was accruable to him on the date of his death. This interpretation of the law produced obvious inequities between those who were on the accrual method and those who were on the cash method. In addition, sizable amounts of income which were not "accruable" as the term was then used escaped taxation. *Held v. Commissioner*, 3 B. T. A. 408 (1926).

The Congress expressed concern over this discrimination and loss of revenue. See Sen. Rep. No. 4558, 73d Cong., 2d Sess. 28 (1934). It provided in section 42 of the Revenue Act of 1934 that the last return of every decedent should include "amounts accrued up to the date of his death." 48 Stat. 680, 694. While this provision effected an equality between decedents on the cash and accrual methods of accounting, it often resulted in pyramiding into the decedent's final return large amounts of income which except for death would have been spread over a number of years and subjected to lower rates of tax. See Sen. Rep. No. 1631, 77th Cong., 2d Sess. 100 (1942). In addition, the Supreme Court in *Helvering v. Estate of Enright*, 312 U. S. 630 (1941) greatly extended the meaning of the phrase "amounts accrued up to the date of his death" beyond any accounting concept of accrual developed by the decisions to that date. Lower court decisions followed taxing to decedents various sorts of inchoate or conjectural gains with the result that the pyramiding was extended and the possibility existed that taxes requiring current cash might be exacted at death on amounts that might never be collected or collected only after many years.

An exceptional case in this period and one of importance to the present decision was *Burnett v. Com-*

missioner, 2 T. C. 897 (1943), where the taxpayer during his lifetime had been engaged in the cattle raising business and had kept his books on the cash method. The Commissioner sought to tax to the decedent the value of certain cattle which had been raised by the decedent but which remained unsold at the time of his death. The Commissioner theorized that the cattle represented "gross income" to the decedent which had "accrued up to the date of his death", and that the amount thereof was properly includable in decedent's income for the taxable period in which fell the date of his death. The case was governed by section 42 of the Revenue Act of 1938, 52 Stat. 447, 473, which repeated verbatim the provisions of section 42 of the Revenue Act of 1934, *supra*. The Board of Tax Appeals held for the taxpayer. It refused to extend the result of the *Enright* case and stated that in the absence of a sale or exchange there was no gross income accruable to the decedent within the meaning of section 42 merely from the ownership of property. This was so even though the property had been produced by decedent on his ranches during his lifetime. The case was appealed, the appeal was dismissed, and the Commissioner later acquiesced in this part of the decision. 1944 Cum. Bull. 4.

Finally, however, the cumulative evidence of unfairness of section 42 prompted the Congress to eliminate this unpopular provision and to enact in the Revenue Act of 1942, 56 Stat. 798, 831, the provisions of law now effective, namely section 126 of the 1939 Code which survives now as section 691 of the 1954 Code. It was section 126 which first gave rise to the concept of income in respect of a decedent. The differences between the provisions of the 1939 and 1954

Codes are not significant in the instant case, and we shall use the 1939 Code for purposes of our discussion.

Section 126 of the 1939 Code provides in subsection (a) that the "amount of all items of gross income in respect of a decedent" which are not properly includable in the last or a prior return of a decedent shall be taxed as income in the year received to the decedent's estate or beneficiary actually receiving such amount. Any amounts so received shall be considered to have the same character in the hands of the estate or beneficiary as they would have had in the hands of the decedent if he had lived to receive such amounts. Subsection (b) makes similar provision for certain deductions and credits, and subsection (c) permits an income tax deduction for the estate tax attributable to items taxable under subsection (a).

It is noteworthy that the statute describes how income in respect of a decedent is to be reported, but nowhere does it define precisely what is income in respect of decedent. At least one attempt has been made to amend the law and supply the missing definition, but the measure failed of enactment. H. R. 3041, 86th Cong., 1st Sess. (1959). The courts which have been called on to construe the statute have not put forth any universal test or definition but have proceeded on a case-by-case basis to establish some dimension to the term. These cases are discussed ahead.

Simultaneously, we must also consider section 113 of the 1939 Code, 26 U. S. C. (I. R. C. 1939) §113 (1952 ed.), which provides that the basis of property acquired by a decedent's estate shall be the fair market value of such property at the time of such acquisition. This means that any unrealized appreciation in prop-

erty left by a decedent will escape income taxation on the amount by which the fair market value of the property at the date of decedent's death exceeds the basis of the property in the hands of the decedent. It is immediately apparent that both section 126 and section 113 cannot apply to the same property. If property gives rise to income in respect of a decedent it is not entitled to a stepped-up basis under section 113. If it is property entitled to the basis adjustment of section 113 it will not be taxed as income in respect of a decedent when it is converted into money. Treas. Reg. 111, §29.126-1 (1943), and see 26 U. S. C. (I. R. C. 1954) §1014(c) (1952 ed. supp. III). It should be possible then to approach the problem of what is income in respect of a decedent from a different direction by determining what property is not entitled to an adjusted basis under section 113. But neither the wording of this section, the regulations nor the cases provide any significant guidelines. Indeed, section 113 has been critized as "one of the most clearly illogical of all income tax provisions." Vickrey, *Agenda for Progressive Taxation*, 139 (1947).

We are left then only to work with section 126. Despite the vagueness of the term "income in respect of a decedent," interpretive developments of the last 15 years have established some patterns on which we may reasonably rely and against which we may trace the parties' contentions.

The plaintiff's main contention is that the scope of the present income-in-respect-of-a-decedent-provision is restricted to income which under the 1934-1942 law would have been accrued to the decedent in her last return. That is to say, only income which would prop-

erly have been accruable to the decedent on the date of her death can be designated as income in respect of a decedent when it has subsequently been collected by the estate. In the instant case, the plaintiff continues, the rents, both cash and crops, were not fully ascertainable on the date of decedent's death and were in fact in dispute until some time in 1954. Since they were not fully ascertainable they were not properly accruable to the decedent on the date of her death. Hence, as ultimately collected by the estate the rents are not income in respect of a decedent.

The defendant takes an equally steadfast position. It maintains that income in respect of a decedent is merely that money which would have been reported as income by the decedent if she had but lived to collect it herself. Undoubtedly, had the decedent collected the rents and sold the crops she would have been in receipt of income. Therefore, when her estate collected the rents after her death and sold the crops the monies received were income to the estate and taxable to the estate as income in respect of a decedent.

As fully correct statements of the law we can accept neither party's general contention. We do not agree with the defendant that all money received by the estate is to be treated as it would have been if the decedent had lived and received it. That comprehends too much, and does not adequately distinguish between income earned by the decedent and income earned entirely by the estate after decedent's death. See Rev. Rul. 57-554, 57-2 Cum. Bull. 361; Rev. Rul. 60-227, 60-1 Cum. Bull. 262. Neither can we accept the plaintiff's position that only items properly accruable to the decedent on the date of her death—in an accounting

sense—are taxable to her estate as income in respect of a decedent. This comprehends too little and gives overriding significance to the indefinite term "accruable."

Certainly the Congress has been concerned with removing discrimination between cash and accrual method taxpayers, and with avoiding the unfair bunching problems which arose under prior law when all sums due to a decedent were accrued to him on the date of his death. But the Congress has also been concerned with retrieving lost revenue. Section 126 is intended to further the general purpose of the Internal Revenue Code that all income should pay a tax. We think it clear that the intent of the Congress in enacting this section continued to be, as stated by the Supreme Court in *Enright*, "to cover into income the assets of decedents, earned during their life and unreported as income." 312 U. S. at 644. The income in respect of a decedent provision represents an attempt to implement these policies in a manner which reduces the importance of death in the actual collection of the revenue. See *Commissioner v. Linde*, 213 F. 2d 1 at 5 (9th Cir. 1954).

The plaintiff's asserted position has been rejected in a series of cases which has evolved mainly in the partnership area. Money paid to the widow or to the estate of a deceased partner has been held taxable as income in respect of a decedent even though it was perfectly clear that on the date of death the deceased partner had no ascertainable claim to the money and could not properly have accrued the amounts ultimately received by his estate. In *Riegelman v. Commissioner*, 253 F. 2d 315, 318-319 (2d Cir. 1958), the question

was "whether the post-death partnership income received by Riegelman's estate constitutes 'income in respect of a decedent.' * * *." The court stated: "The payments were not gifts, nor were they attributable to anything done by Riegelman's estate. They were the fruits of the man's professional activity during his lifetime; * * *" The case of *United States v. Ellis*, 264 F. 2d 325 (2d Cir. 1959), was almost identical to *Riegelman* and the court again taxed receipts from a partnership to a deceased partner's estate as income in respect of a decedent. Similarly, in *O'Daniel's Estate v. Commissioner*, 173 F. 2d 966 (2d Cir. 1949), the court held that a bonus payment to an officer of a small corporation designated and fixed some 4 months after his death came within section 126 and "clearly represented compensation for his services and any right to receive it that was realized by his estate was acquired through him and never arose in any other way or through any other source." See also *Bausch's Estate v. Commissioner*, 186 F. 2d 313 (2d Cir. 1951).

In *Commissioner v. Linde*, 213 F. 2d 1 (9th Cir. 1954), the decedent, the owner of a vineyard, had delivered grapes to various cooperatives for conversion into wine and for the sale of the wine. The liquidation of the wine pools by the conversion of the grapes and the disposition of the wine did not occur until after the decedent's death. Even though no sales of the grapes to the cooperatives had occurred the court held that the payments which the decedent's estate received from the cooperatives after the decedent's death were realized in consequence of contracts and deals made by the decedent in his lifetime. "No act or thing taken or performed by the taxpayer [the estate] operated to pro-

cure or to give rise to this payment. Such payments had their source exclusively in the decedent's contract and arrangement with the cooperative associations." 213 F. 2d at 4. The court concluded that these payments constituted income in respect of a decedent and were taxable as such.

The situation in the instant case is much the same as in the cases cited above. These are the important considerations: the rents received by the plaintiff are directly attributable to economic activities which occurred prior to decedent's death; they would have been income to the decedent had she but lived to receive them; they were fully accruable to the decedent on the date of her death in the sense that she was fully entitled to receive them but orthodox accounting technique prevented their accrual solely because they were not ascertainable in amount; they were not attributable to any acts performed by the estate nor were they attributable to unrealized passive appreciation of property owned by the decedent at the date of her death. These diverse characteristics do not permit of easy generalization, and we cannot draw from them a rule as to what is income in respect of a decedent in all cases. It is fair to say, however, in light of the development of the statute, that each of these characteristics represents an element in the composite concept that is income in respect of a decedent.

The rent on the Eloy tract was payable in cash, albeit it was to be ascertained in amount as a percentage of the net proceeds received from the sale of crops grown on the tract. As a cash rent we find it indistinguishable from any other kind of cash rent that might have arisen, as under a residential or commercial lease. On

the basis of the foregoing discussion we find that this rent, collected by the estate, is income in respect of a decedent and taxable as such.

The rent on the Coolidge tract was by the terms of the lease not only to be ascertained from the amount of crops grown on the tract but it was also to be paid in crops. While the receipt of rent in property rather than in cash would not seem to affect the income character of the payments, crop-rents have frequently received special treatment under various provisions of the revenue acts and they must now be given further consideration.

Section 61 of the 1954 Code, 26 U. S. C. (I. R. C. 1954) §61, specifically includes rents in the definition of gross income. The regulations repeat this directive of the Code. However, the regulations also describe the computation of farm income as follows: "Crop shares (whether or not considered rent under state law) shall be included in gross income as of the year in which the crop shares are reduced to money or its equivalent." This same rule is announced for farmers using the cash method and the accrual method of accounting. Treas. Reg. §1.61-4 (1957), derived from Treas. Reg. 118, §39.22(a)-7(c) (1953). It further appears that only an actual sale of the crops is a reduction to money or its equivalent as the regulations describe. *Perry v. United States*, 58-2 USTC §9587 (D. C. Miss. 1958); *SoRelle v. Commissioner*, 22 T.C. 459 (1954). See also Rev. Rul. 55-496, 56-2 Cum. Bull. 71. The lessor who has received crop-rent has of course received an asset of value, but as a matter of administrative convenience the recognition of this value as income is deferred until the crops are reduced to

money. Crops received as rent exist in the hands of the lessor as a unique kind of property which can be described, like a right to receive future income, as a potential income asset. *Cf. Citizens Federal Savings and Loan Association of Cleveland v. United States*, No. 502-58 (Ct. Cl. June 7, 1961); *Williamson Well Service Corporation v. United States*, No. 86-59 (Ct. Cl. July 19, 1961).

Now if a landlord died while in possession of certain crops which he had received as rent we believe that under present law the essential income nature of these crops would follow the crops into the landlord's estate. The crops would remain *crop-rents* in the hands of the estate and would represent a form of income in respect of a decedent. Furthermore, under section 126 these crop-rents would be considered in the hands of the estate to have the same character which they had in the hands of the decedent—the potential of producing taxable income through sale. Only when the estate finally sold the crops would income be recognized. But at that point the money derived from the sale would be taxable; and taxable as income in respect of a decedent.

We are aware that this view of the law does not accord with Rev. Rul. 58-436, 58-2 Cum. Bull. 366. We believe that ruling is an improper extension of the holding of the court in *Burnett v. Commissioner, supra*, and is not a correct exposition of the law. The *Burnett* case, as we have mentioned, arose prior to the enactment of section 126, and concerned the propriety of accruing in the decedent's last return the value of cattle which the decedent had raised and which he still owned at the time of his death. No rents were involved. The court held that the value of the unsold

cattle should not be accrued to the decedent as income as of the date of his death. Considering the then existing law, we agree with the result reached by the court. But the case cannot be extended and given new meaning under the present law which is based on an amplified and entirely different concept of taxing the earnings of a decedent. See *Commissioner v. Linde*, *supra*, at 6 and 7.

In the instant case the decedent has not received the disputed crop-rents. The plaintiff can derive no benefit from this fact. The decedent's estate comprised among other things a right to collect crop-rents that had been earned prior to decedent's death. As *rents* these crops were income in respect of a decedent according to the first part of this opinion. As *crop-rents* they first became recognized as income and taxable when they were sold for the account of the estate. At that point the income-producing potential of the crops had been fully achieved and was taxable. In this manner congressional purpose is fulfilled. The privilege of not recognizing the crop-rents as income until their sale is extended from the decedent to her estate, but what is in reality earned income does not escape its intended proportionate burden of taxation.

Accordingly, the refund of income taxes here sought by the plaintiff is denied. The petition will be dismissed.

It is so ordered.

DURFEE, *Judge*; LARAMORE, *Judge*; MADDEN, *Judge*, and WHITAKER, *Judge*, concur.

APPENDIX B.

Sec. 126. INCOME IN RESPECT OF DECEDENTS.

(a) Inclusion in Gross Income.—

(1) GENERAL RULE—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

* * *

Sec. 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS.

(a) Inclusion in Gross Income.—

(1) GENERAL RULE.—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in

respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's death from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

* * *